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FM AMEMBASSY JAKARTA  
TO RUEHC/SECSTATE WASHDC 7987  
RUEATRS/DEPT OF TREASURY WASHDC  
INFO RUEHJS/ASSOCIATION OF SOUTHEAST ASIAN NATIONS  
RUCPDO/DEPT OF COMMERCE WASHDC  
RUEHKO/AMEMBASSY TOKYO 9933  
RUEHBJ/AMEMBASSY BEIJING 3546  
RUEHBY/AMEMBASSY CANBERRA 9776  
RUEHUL/AMEMBASSY SEOUL 3708  
RUEAIIA/CIA WASHDC

UNCLAS SECTION 01 OF 04 JAKARTA 009526

SIPDIS

SIPDIS

DEPT FOR EAP/MTS AND EB/IFD/OMA  
TREASURY FOR IA-SETH SEARLS  
COMMERCE FOR 4430/GOLIKE  
DEPARTMENT PASS FEDERAL RESERVE SAN FRANCISCO  
DEPARTMENT PASS EXIM BANK

E.O. 12598: N/A

TAGS: [EFIN](#) [EINV](#) [ECON](#) [PGOV](#) [ID](#)

SUBJECT: INDONESIA - 2006 BUDGET REVISIONS

REF: JAKARTA 8006

11. Summary. On July 12 the Minister of Finance presented the Parliament Government of Indonesia's (GOI) revisions to the 2006 budget. Significant changes include an increase in international oil price assumption to USD 62/barrel from USD 57, avoiding last year's mistake of clinging to an low oil price assumption in a global environment of rising prices. The GOI expects revenue-to-GDP of 13.6 percent in 2006. Despite double digit inflation in the first half of the year, the inflation estimate remained unchanged at 8 percent. The interest rate assumption rose to 12 percent, from 9.5. Government spending for 2006 has been slow, with only 38 percent disbursed by early July. The budget deficit prediction rose to 1.3 percent of GDP from 0.7 percent. Bank financing, government bonds and donor loans and grants will cover Indonesia's budget deficit. End Summary.

12. Note: We use the Rp 9,210/USD market exchange rate on July 14 throughout this report, which is slightly stronger than the GOI's budget assumption exchange rate of Rp 9,300/USD. The GOI fiscal year runs on a calendar year basis. End Note.

#### Revised Forecasts -----

13. On July 12, the Minister of Finance (MOF) presented to Parliament's Budget Committee, mid-year revisions to the 2006 budget. In anticipation of higher government spending to help spur growth, the GOI increased this year's budget deficit estimate to 1.3 percent of GDP from 0.7 percent. The MOF also revised the oil price assumption upward to USD 62/barrel from USD 57. Observers see this as the GOI's attempt to avoid last year's mistakes. In 2005, the GOI stood by a low oil price assumption in a rising global fuel price environment, leading to concerns about the swelling fuel subsidy and fiscal sustainability. The revisions for 2006 include a stronger exchange rate of Rp 9,300/USD instead of 9,900, and a higher benchmark interest rate of 12 percent up from 9.5 percent. Despite double digit inflation in the first half of the year, the inflation estimate remained unchanged at 8 percent.

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Table 1: FY 2006 Budget Assumptions

Assumptions	2005	2006	2006 (Proposed Revision)
Real GDP growth (1)	6.0	6.2	5.9
CPI inflation	8.6	8.0	8.0
USD/IDR (avg)	9,800	9,900	9,300
3-month SBI rate (avg)	8.4	9.5	12.0
Budget deficit (2)	0.9	0.7	1.2
Average oil price (3)	54	57	62
Oil production (4)	1,075	1,050	1,000

- (1) In percent  
(2) As percentage of GDP  
(3) In USD per barrel  
(4) In million barrels per day

#### More Tax Revenues

14. Overall, revenue (including foreign grants) is expected to reach Rp 651.9 trillion (USD 70.8 billion) in 2006, an increase over the Rp 625.2 trillion (USD 67.9 billion) previously estimated. MOF revenue projections consist of tax receipts of Rp 423.5 trillion (USD 46 billion), non-tax revenue of Rp 224.5 trillion (USD 24.4 billion) and grants of Rp 3.9 trillion (USD 423.5 million). The revised budget predicts the revenue-to-GDP ratio will rise to 13.6 percent, an increase over last year's 13.3 percent. The budget also assumes declining international trade tax revenues due to tariff harmonization and international treaties.

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Table 2: FY 06 Revenues (in trillions of Rupiah)

Items	2005	2006	2006 (Proposed Revision)
Domestic Revenue	532.7	621.6	648.0
- Oil and gas	175.8	183.7	193.8
- Non-oil and gas	356.9	437.9	454.2
Foreign Grants	7.5	3.6	3.9
Tot. Revenue/Grants	540.2	625.2	651.9

#### 2005 Carry-Over Spending

15. On the expenditure side, the revised budget estimates show subsidies of Rp 104.3 trillion (USD 11.3 billion) mainly for fuel, and interest payments of Rp 83.5 trillion (USD 9 billion), of which interest on domestic debt takes Rp 58.4 trillion (USD 6.3 billion). The GOI postponed plans to increase electricity tariffs and continues to prop up the insolvent, state-owned electricity firm PLN. On the upside, however, Jakarta was able to revise downward interest expenditures for foreign debt due to rescheduling. On June 28, Finance Minister Sri Mulyani Indrawati announced that a fiscal surplus was likely in the first half of the year, despite the central government's attempt to stimulate the economy by "front loading" 2006 spending, including disbursing unspent funds of more than Rp 10 trillion (USD 1 billion) left over from the 2005 budget.

#### 2006 Spending Slow

16. The central government's budget execution in first quarter 2006 was better than in 2005 but lower than the GOI had planned. The inability or unwillingness of regional governments to spend the funds disbursed to them by the central government--in 2006 amounting to fully 32 percent of total government expenditures--remains a concern because it creates a drag on the economy and undermines the Finance

Ministry's control over fiscal policy execution. By July 7 only 38 percent of annual 2006 budget expenditures had been spent. Analysts blame regional under-spending on the slow pace of bureaucratic reform and on President Susilo Bambang Yudhoyono's tough fight against graft, which has alarmed local officials to the point that they are refraining from involvement in project procurement. A surge in spending is now expected in the second half of the year as ministries rush to spend their budgets.

Table 3: FY 06 Expenditures  
(in trillions of Rupiah)

Items	2005	2006	2006 (Proposed Revision)
Expenditures	565.1	647.7	689.5
-- Central govt.	411.7	427.6	470.2
- Routine	103.5	135.1	134.2
- Capital	54.8	62.9	67.0
- Interest	61.0	76.6	83.5
- Subsidies	119.1	79.5	104.3
- Social	30.0	36.9	37.2
- Others	43.4	36.5	43.9
-- Transfers to regions	153.4	220.1	219.4
Deficit	(24.9)	(22.4)	(37.6)

#### Domestic Financing Increases

17. Budget financing will include Rp 35.8 trillion (USD 3.9 billion) from government investment accounts and bond sales, and Rp 39.9 trillion (USD 4.3 billion) in foreign loans and grants. Donors pledged USD 4.3 billion in on-budget loans and grants to cover Indonesia's financing gap at the June 14

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CGI meeting (reftel) in addition to USD 1.5 billion in off-budget assistance. Smaller financing sources include divestment of bank shares held by the State Asset Management Company (PPA). PPA still holds a 26 percent stake in Bank Permata, and 5.5 percent in Bank Internasional Indonesia (BII).

Table 4: FY 06 Financing (in trillions of Rupiah)

Items	2005	2006	2006 (Proposed Revision)
Financing	24.9	22.4	37.6
-- Domestic (net)	29.8	50.9	52.4
- Bank financing	4.3	23.0	14.5
- Privatization	3.5	1.0	3.0
- Assets restructuring	5.1	2.3	2.4
- Govt bonds (net)	22.1	24.9	35.8
- Capital participation	(5.2)	(0.4)	(3.3)
-- Foreign loans (net)	(4.8)	(28.5)	(14.8)
- Program loan	11.3	9.9	13.9
- Project loan	24.3	25.2	25.9
- Amortization	(40.4)	(63.6)	(54.7)

Table 5: FY 2005 Budget and  
FY 2006 Budget (Proposed Revision)

Items (1)	FY 2005		FY 2006	
	Rp Trill.	Percent GDP	Rp Trill.	Percent GDP

<u>¶</u> A. Total revenue	540.2	20.4	651.9	20.9
<u>¶</u> I. Domestic revenues	532.7	20.1	648.0	20.8
Tax revenues	352.0	13.3	423.5	13.6
Domestic taxes	334.4	12.6	408.8	13.1
Income tax	180.3	6.8	212.3	6.8
<u>¶</u> 1. Oil and gas	37.2	1.4	37.3	1.2
<u>¶</u> 2. Non oil/gas	143.0	5.4	175.0	5.6
Value added tax	102.7	3.9	132.9	4.3
Land/bldg tax	13.4	0.5	18.2	0.6
Duties on land/ building transfer	3.7	0.1	4.4	0.1
Excise tax	32.2	1.2	38.5	1.2
Other taxes	2.2	0.1	2.6	0.1
Int. trade tax	17.6	0.7	14.6	0.5
Non-tax revenues	180.7	6.8	224.5	7.2
Natural resources	144.4	5.4	161.9	5.2
SOE profits	12.0	0.5	21.7	0.7
Other	24.3	0.9	40.9	1.3
II. Grants	7.5	0.3	3.9	0.1
<u>¶</u> B. Expenditures	565.1	21.3	689.5	22.1
Central govt. exp.	411.7	15.5	470.2	15.1
Personnel	61.2	2.3	79.6	2.5
Material exp.	42.3	1.6	54.6	1.7
Capital exp.	54.7	2.1	67.0	2.1
Interest payments	61.0	2.3	83.5	2.7
Subsidies	119.1	4.5	104.3	3.3
Social assistance	30.0	1.1	37.2	1.2
Other current exp.	43.4	1.6	43.9	1.4
Transfer to regions	153.4	5.8	219.4	7.0
Overall balance	(24.9)	(0.9)	(37.6)	(1.2)
Financing	24.9	0.9	37.6	1.2
Domestic financing	29.8	1.1	52.4	1.7
Domestic banks	4.3	0.2	14.5	0.5
Privatization	3.5	0.1	3.0	0.1

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Assets restructuring	5.1	0.2	2.4	0.1
Govt debt	22.1	0.8	35.8	1.1
Foreign financing (net)	(4.8)	(0.2)	(14.8)	(0.5)
Gross drawing	35.5	1.3	39.9	1.3
Program loan	11.3	0.4	13.9	0.4
Project loan	24.3	0.9	25.9	0.8
Amortization of foreign debt (net)	(40.4)	(1.5)	(54.7)	(1.8)

(1) Column totals may not add perfectly due to rounding.

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